Kaiser Resources Ltd. Annual Report 1978

Kaiser Resources Ltd.

Kaiser Resources Ltd. is a diversified Canadian energy company incorporated in the province of British Columbia. The Company is engaged primarily in the production and sale of metallurgical coal, used in steelmaking, and in the exploration for and production of crude oil and natural gas.

The Company is Canada's largest producer of metallurgical coal, operating surface and underground mines and coal processing facilities at Sparwood, in southeastern British Columbia. It is engaged in engineering and in licensing hydraulic mining technology. It also operates a coal-handling port facility at Roberts Bank, south of Vancouver.

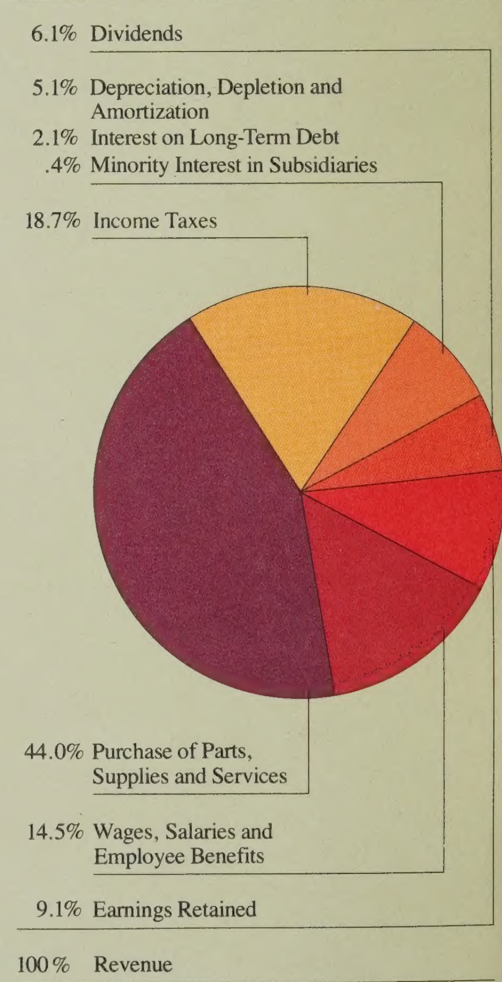
The Company produces crude oil and natural gas, primarily in western Canada, and is engaged in exploration for oil and gas in the traditional and frontier regions of Canada and in foreign countries. It is also engaged in asphalt paving and related construction activities and in the sale of asphaltic concrete and aggregate material.

Highlights

	1978	1977	% Change
Thousands except per share data			
Revenue	**$408,166**	$307,727	33
Net earnings	**62,144**	57,282	8
Net earnings per share	**2.32**	2.14	8
Dividends per share	**.925**	.87	6
Funds provided by operations	**108,036**	84,666	28
Working capital	**67,289**	125,817	(47)
Capital expenditures	**43,953**	33,542	31
Total assets	**866,666**	312,755	177
Total long-term debt	**353,060**	—	—
Employment costs	**59,387**	46,698	27
Coal division shipments — Thousand tons:			
Metallurgical coal	**5,214**	4,881	7
Thermal coal	**403**	485	(17)
Coke and breeze	**121**	112	8
Oil and gas production: Three months ended December 31, 1978			
Crude oil and natural gas liquids —			
Thousand barrels	**2,477**		
Daily average — Thousand barrels	**26.9**		
Natural gas —			
Million cubic feet	**6,548**		
Daily average — Million cubic feet	**71.2**		
Number of shareholders	**6,076**	6,398	(5)
Number of employees	**2,730**	1,930	41

Tonnage figures in this report are expressed in long tons (2,240 pounds) except where indicated as short tons (2,000 pounds) or metric tons (2,204.6 pounds).

Distribution of Total Revenue



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Net earnings per share	3.32	3.14	8
Dividends per share	.925	.87	6
Funds provided by operations	[illegible]	84,606	28
Working capital	[illegible]	[illegible]	(47)
Capital expenditures	[illegible]	[illegible]	[illegible]
Total assets	[illegible]	[illegible]	[illegible]
Total long-term debt	[illegible]	—	—
Employment costs	59,387	[illegible]	27
Coal division shipments — Thousand tons			
Metallurgical coal	5,214	4,881	7
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Oil and gas production [illegible]			
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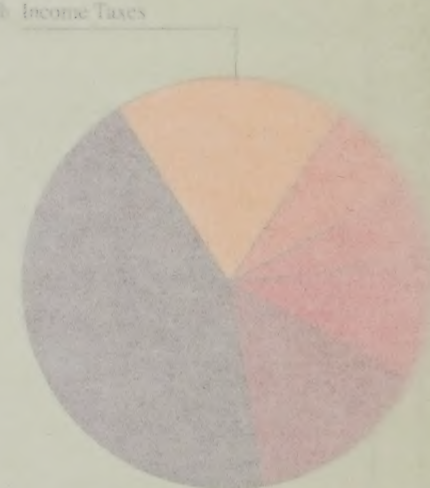
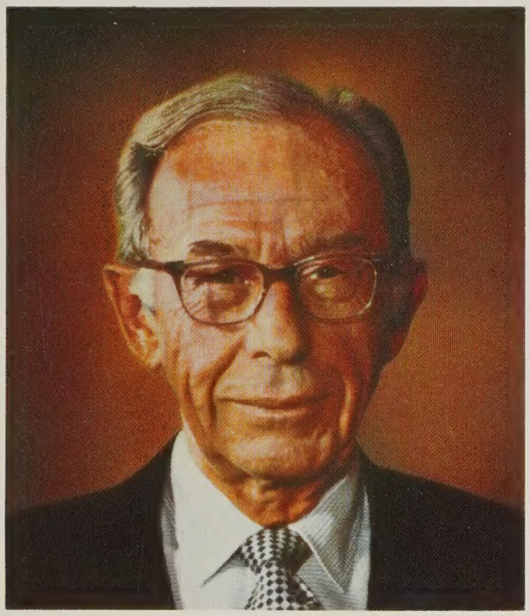


Edgar F. Kaiser



"We must make our investment of heart as surely as we make our investment of money. Our returns must be in terms of people, their aspirations, their hopes and ideals, as surely as they are expressed in the balance sheets."

— Edgar F. Kaiser

A corporation is not unlike an individual. Its prosperity and reputation are directly related to its performance and public service.

This report is a reflection of the recent achievements of Kaiser Resources and the Company's rapidly growing involvement in Canada's energy industry.

Yet it is more. In a very real sense, Kaiser Resources' present success is a tribute to the leadership and integrity of Edgar F. Kaiser.

During his chairmanship of the Company in its critical formative years, Edgar Kaiser's will and determination enabled us to overcome many difficult problems. His sensitivity to the needs of people and society provided a depth and dimension unusual in the business world. And not least, his vision and enthusiasm laid the foundation for the diversified energy base we enjoy today.

A man of prodigious energy and unshakeable faith, Edgar Kaiser has never allowed his business commitments to overshadow his interest in people. His belief that people the world over understand each other best when they work together is born of personal observation and experience, and exemplified in the diversity of successful partnerships he has established throughout the world.

In 1978, Edgar Kaiser retired as chairman of the board of directors of Kaiser Resources. We hold his continuing association with the Company as chairman emeritus and honorary director to be among our major assets.

The legacy of his wide ranging contribution to our present profitability and international standing is certain to profoundly influence the Company's growth and direction for many years to come.

To Our Shareholders

Our sixth consecutive year of profitable operation was notable for increased earnings, record revenues, and the acquisition of Ashland Oil Canada Limited, a major firm operating in the field of oil and gas exploration and production.

Consolidated net earnings totalled $62.1 million or $2.32 per share in 1978, compared with $57.3 million or $2.14 per share in 1977. Total revenue reached $408.2 million, surpassing the previous high of $307.7 million established in 1977.

The eight percent increase in earnings was attributable primarily to record shipments and higher prices for metallurgical coal. Funds provided by operations rose by 28 percent to a record $108 million or $4.03 per share in 1978, up from $84.7 million or $3.16 per share in 1977.

This rate of growth will enable the Company to plan additional expansion when and where opportunities arise without restricting the development of existing operations.

Capital expenditures increased by 31 percent to $44 million as we continued to invest in the land, equipment and buildings necessary to maintain and expand our operations.

Coal Market Development

It has been the Company's policy to establish a balance in our markets, safeguarding our shareholders' investment while enhancing prospects for consistent profitability.

Our strategy continues to emphasize diversification of our markets, particularly among those countries which show the greatest potential for increased steel production. Because of this, the decline in shipments of coal to our Japanese customers which began in 1975 has been offset, and metallurgical coal shipped by the Company exceeded five million tons for the first time. Of this total, four million tons were shipped to Japan and 1.2 million tons to steel mills in nine other countries. This represents a 70 percent increase over 1977 in tonnage delivered to markets other than Japan.

The Company's success in penetrating new markets was directly related to increased productivity and competitive pricing. The former reflects the advantages of scale inherent in the operation of Canada's largest metallurgical coal mine; the latter has been helped by the decline of the Canadian dollar in recent years.

We foresee a modest improvement in demand for metallurgical coal in 1979 as world steel production continues its gradual recovery from depressed levels. We anticipate an acceleration of this demand beginning in 1980, particularly in developing countries where steel production is expected to increase at an annual average of eight percent. This rate could be more than double that of the industrialized western nations during the next decade. With capacity in excess of six million tons per year and the ability to add further processing capacity at low incremental cost, Kaiser Resources is well positioned to capitalize on this increased demand.

Kaiser Oil

On October 3, 1978, Kaiser Resources paid a total of $368 million, or $33.50 per share, for a 79 percent interest in Ashland Oil Canada Limited. The remaining shares outstanding were purchased through an offer to public shareholders, giving Kaiser Resources 100 percent control.

There were a number of sound reasons for this major diversification into the oil and gas sector of the energy industry.

Although different in scope and character, the acquisition parallels our previous investments with Petro-Canada in the Sable Island area and Dome Petroleum in the Beaufort Sea. Moreover, we feel that our equity base can be employed more effectively in oil and gas than in any other industry group at this time. Because of the continued volatility of foreign energy supplies and threatened world shortages, it is likely that growth in the energy field will outperform other sectors of the economy. The Oil and Gas Division has a fine record of performance, having increased earnings and funds provided by operations at a compound rate of 30 percent and 19 percent, respectively, during the past seven years.

The Company conducts its oil and gas operations through Kaiser Oil, which has established reserves capable of producing 27,000 barrels of oil and 90 million cubic feet of gas per day. In addition, shut-in gas reserves provide the capacity for increased production at such time as new markets develop. With oil and gas rights on 3.5 million acres in prime exploration areas of Western Canada, the Company is in a favourable position to expand its base in the energy field.

Kaiser Oil spent more than $36 million on development of prime oil and gas properties last year, an amount we plan to increase by a minimum 33 percent to $48 million in 1979. We are confident that these expenditures will result in greater annual production and a substantial improvement in established reserves. Our strong exploratory position in the Deep Basin area of northwestern Alberta should contribute significantly to the development of additional gas reserves. We are also optimistic about the oil and gas potential of our holdings in northeastern British Columbia.

Initial results of the acquisition have exceeded our expectations, and the positive match of personalities and potential should enhance our future growth and development. The Company continues to seek development opportunities in other potentially productive areas.

New Organization

It is with confidence and respect that we welcome Kaiser Oil's management team into our corporate structure. Their proven ability to take decisive action on exploration opportunities and to operate efficiently in the ongoing business of producing oil and gas has earned considerable respect within the industry.

Following the acquisition, the Company implemented a new organizational structure with two key operating divisions. Walter J. Riva, formerly vice-president of mining operations, was appointed president of the Coal Division, and William J. Whelan, formerly executive vice-president of Ashland Oil Canada, was appointed president of the Oil and Gas Division. Both men have had many years of experience in their respective fields and have been elected directors of Kaiser Resources.

The Outlook

As we approach the 1980's, Kaiser Resources is stronger than ever in all essential areas — in human and natural resources, technology, capital and cash flow.

At a time when the world is experiencing considerable difficulty with its energy supplies, we are fortunate to have access to immense coal and hydrocarbon reserves in a country as stable and progressive as Canada. While we cannot escape the impact of global economic fluctuations, there can be little doubt that such valuable assets will be decisive to our corporate and national prosperity in the years ahead.

The Coal Division produces nearly 50 percent of Canada's exports of metallurgical coal and supplies Japan, our largest customer, with eight percent of its metallurgical coal imports. Extensive deposits have been established adjacent to our present mines which can sustain current levels of production well into the next century.

Prospects for the Oil and Gas Division appear to be equally favourable. Recent reports by the National Energy Board confirm a natural gas surplus in Canada which creates the possibility of additional exports to the United States. The federal government has also proposed a more flexible pricing system for natural gas to encourage expansion into Eastern Canadian markets which presently depend on imported oil.

In short, both the coal and oil and gas divisions are well positioned to contribute significantly to the Company's growing asset base and increasing cash flow in the years ahead.

Environment and Economics

The Company continues to lead in the development and application of reclamation technology and has received the British Columbia Mine Reclamation Award from the provincial Ministry of Energy, Mines and Petroleum Resources for the second time in three years. Since 1970, 2,000 acres of land have been successfully reclaimed.

Last year's record $408 million in revenues contributed materially to Canada's balance of payments. Taxes and royalties exceeded $106 million. This, plus the permanent employment of more than 2,700 highly-skilled men and women with a payroll of nearly $60 million, provide tangible evidence of the importance of energy exploration and development in Canada.

In summary, Kaiser Resources is now a well diversified energy company with $867 million in assets, 65 percent of which are in oil and gas, 25 percent in coal and 10 percent in asphalt paving. By continuing to expand our energy related enterprises, we expect to remain a strong, well balanced company capable of vigorous and profitable growth in the years ahead.

Our principal resource continues to be the men and women who together have built the company you own today. Their hard work, dedication and technological foresight have carried us through our difficult early years to a position of leadership in our industry. As we confront today's increasingly complex problems and opportunities, these same qualities will ensure that Kaiser Resources remains in the forefront of Canadian energy exploration and development.

With your continued support, we look forward to tomorrow.

April 18, 1979

Edgar F. Kaiser, Jr.
Chairman & Chief Executive Officer

Kaiser Resources Ltd.

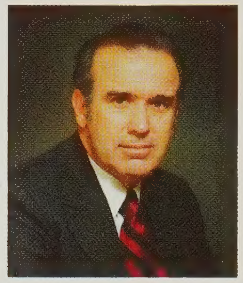
Officers

Edgar F. Kaiser, Jr.

Graham R. Dawson

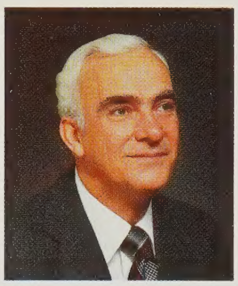
Walter J. Riva

William J. Whelan



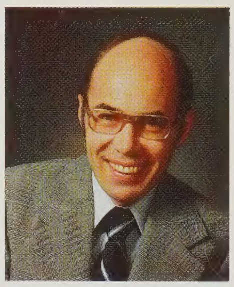
Howard E. Cadinha

George L. Farinsky



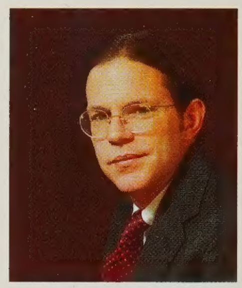
Robert W. MacPhail

Christopher H. Hebb



Hans J. Krutzen

Ward P. Popenoe



Michael R. Whitman

Bent H. Larsen

Thomas A. Beckett

Edgar F. Kaiser, Jr.
Chairman of the Board
Chairman of the Executive Committee
Chief Executive Officer

Graham R. Dawson
Vice-Chairman of the Board

Walter J. Riva
President
Coal Division

William J. Whelan
President
Oil and Gas Division

Howard E. Cadinha
Executive Vice-President
Finance and Administration

George L. Farinsky
Senior Vice-President
Corporate Development

Robert W. MacPhail
Senior Vice-President

Christopher H. Hebb
Vice-President
General Counsel and Secretary

Hans J. Krutzen
Vice-President
Executive Division

Ward P. Popenoe
Vice-President
Administration

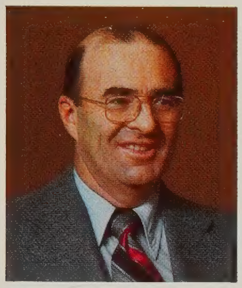
Michael R. Whitman
Vice-President

Bent H. Larsen
Controller

Thomas A. Beckett
Assistant Secretary
Chief Counsel
Coal Division

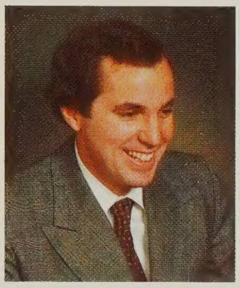
Coal Division

Senior Management


Walter J. Riva


Gary K. Livingstone

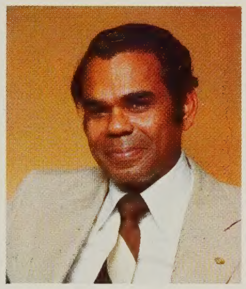

Gordon M. Edgar


Robert C. Stanlake


Robert H. Gronotte

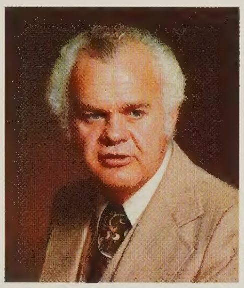

John H. Harvie


Brian L. McDermott


Peter J. Surrao


Richard W. Lewis


L. Junie Lindsay


Lawrence W. Riffle


Nigel Stonestreet

Walter J. Riva
President

Gary K. Livingstone
General Manager
Mining Operations

Gordon M. Edgar
President
Westshore Terminals Ltd.

Robert C. Stanlake
Vice-President
Marketing & Sales

Robert H. Gronotte
Vice-President
Engineering

John H. Harvie
Vice-President
Marketing & Sales —
Far East

Brian L. McDermott
Vice-President
Marketing & Sales —
Latin America

Peter J. Surrao
Controller

Richard W. Lewis
General Superintendent
Underground Mines

L. Junie Lindsay
General Superintendent
Coal Processing

Lawrence W. Riffle
General Superintendent
Harmer Operations

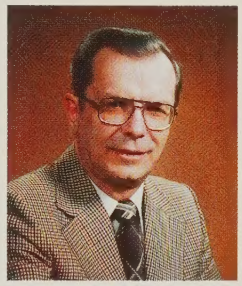
Nigel Stonestreet
General Superintendent
Mine Engineering &
Planning

Oil and Gas Division

Senior Management

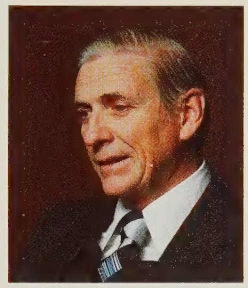

William J. Whelan


Colin M. Evans

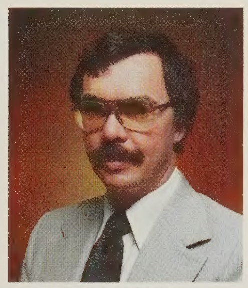

Lawrence G. Link


Joseph S. Irwin, Jr.


Andrew D. Berry


C. James Donnelly


Frank E. Starratt


J. David Weddell

William J. Whelan
President

Colin M. Evans
Executive Vice-President

Lawrence G. Link
Executive Vice-President
(Asphalt Paving &
Materials)

Joseph S. Irwin, Jr.
Senior Vice-President

Andrew D. Berry
Exploration Manager

C. James Donnelly
Operations Manager

Frank E. Starratt
Engineering Manager

J. David Weddell
Land Manager

Gains in production were recorded throughout the Coal Division in 1978. Despite the softness which has persisted in international markets since 1975, production of raw metallurgical coal from surface and underground mining operations increased to 6.5 million tons from 6.1 million tons in 1977.

The Division produces nearly one-half of Canada's exports of metallurgical coal, used in steelmaking. It operates a surface mine and two underground mines in the Sparwood area of southeastern British Columbia, including North America's only underground hydraulic coal mine. Operations also include a modern coal preparation plant at Sparwood for processing metallurgical coal to sales contract specifications, and a highly efficient bulk-handling port facility at Roberts Bank, south of Vancouver.

The Division's mine engineering and planning group has established that vast coal deposits, which lie adjacent to present mines, could be developed to sustain current levels of production beyond the year 2000. The location of these deposits means that the existing infrastructure, including the Elkview preparation plant, is well positioned to support continuing operations.

Preliminary study of the Greenhills coal property, 26 miles north of Sparwood, indicates substantial reserves of coal which could be mined well into the 21st century. A rail line, road, power, gas, water and two communities are already in place for servicing the property as soon as market conditions warrant development.

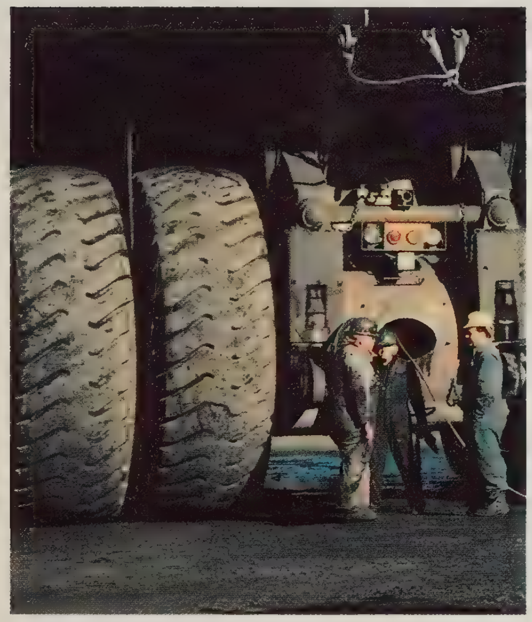
Construction of a new administration building at Sparwood began during 1978. The $4 million, two-storey structure is scheduled for completion in early 1980. It provides for 63,000 square feet of office space and will replace the present administrative quarters at Sparwood. Construction of a $4 million warehouse is scheduled to begin in 1979. The new facility will provide approximately 500,000 cubic feet of storage space for some 35,000 items and will incorporate specialized equipment for retrieval and distribution.

Surface Mining and Maintenance

Production of raw metallurgical coal from surface mining operations increased to 5.7 million tons in 1978 from 5.3 million tons in 1977, an improvement of nine percent. The surface operations are conducted 24 hours a day, seven days a week, and account for approximately 85 percent of total raw metallurgical coal production.

The world's largest truck, the 350-ton Terex Titan, was introduced in 1978 and is being tested to determine its cost efficiency and operating characteristics in the removal of overburden. Three 170-ton trucks acquired in 1977 performed successfully throughout the year.

The Division is continuing a performance study to determine whether it is more economical to rebuild its fleet of 200-ton trucks,



The 350-ton Terex Titan (right) begins performance tests in the removal of overburden at the Sparwood surface mining operations. Designed and built by Canadians, the truck has a payload equal to that of 700 pickup trucks. When dumping, its height is equal to a six-storey building.

A 200-ton truck is all but lost in the surrounding winter beauty high in the mountains of southeastern British Columbia (left). The spoil pile being created will be resloped and seeded in grass as part of the Coal Division's reclamation program.

or to replace the units with new equipment. Two of the 22 units in the fleet were completely rebuilt in 1978 and work began on a third, increasing to five the number of these trucks that have been rebuilt since 1976. The mechanical availability of the rebuilt trucks during 1978 was excellent.

The Division plans to establish a component rebuild facility for major surface mining equipment at a cost of $3.1 million. This facility will increase the technical content of work performed on site by the Division's skilled tradesmen.

Substantial cost savings continue to be achieved as a result of improved drilling and blasting procedures which produce better fragmentation of the rock overburden.

Hydraulic Mining

Underground mining operations produced 783,000 tons of raw metallurgical coal, up slightly from 1977 production of 775,000 tons. Of the total, 649,000 tons were produced by the hydraulic process in which water under extremely high pressure is used to cut coal from inclined seams.

Construction of a new section of the hydraulic mine continued during 1978. The $49 million project will extend the life of the mine by an estimated 14 years. It is scheduled to go into production in late 1979 as reserves in the older section of the mine are depleted. The new section is expected to produce approximately 1.2 million tons of raw coal annually.

The project includes a major materials-handling system and a technologically advanced underground facility designed to separate coarse coal from water used in the hydraulic mining process. The coarse coal will be transported out of the mine by conveyor belt while fine coal will be pumped in slurry form to the dewatering station on the surface.

Underground development of 34,000 feet of main roadway will be completed in the new section before the hydraulic monitor goes into operation. During 1978, development advanced a total of 12,800 feet using two access entries. On the surface, construction of new office and wash facilities for the hydraulic mine are expected to be completed by mid-1979.

Under an agreement between Kaiser Resources, the Soviet Union and Mitsui Mining of Japan, the Coal Division is engaged in licensing its hydraulic mining technology to other companies for application in underground mines. The technology has been licensed to three other companies for use in Western Canada.

The hydraulic mining process involves the use of monitors, such as the one shown here, to direct high-pressure jets of water at the coal seam.

The hydraulic mine's new underground dewatering station (left) includes a slurry pumping system with a capacity to handle 8,000 imperial gallons per minute.

The Elkview coal preparation plant (right) is scheduled to have a new high energy scrubber installed during 1979.

Coal Processing

The Elkview preparation plant, in which raw coal is washed to reduce incombustible material to sales contract specifications, processed 5.3 million tons of clean metallurgical coal in 1978, up from 4.7 million tons in the previous year.

Processing operations also produced 531,000 tons of thermal coal, 118,000 tons of coke and breeze, and 629,000 imperial gallons of tar.

As previously reported, a $4.2 million modification program has increased the Elkview plant's production capacity to more than six million tons of clean metallurgical coal per year. Preliminary studies into additional plant modifications are underway and could result in further increases in production capacity. Also under study is the possible construction of a new preparation plant dryer which could also process thermal coal, as well as the feasibility of installing limited cleaning capacity at the hydraulic mine's dewatering facility.

During 1978, a permanent new topping-off control was incorporated into the railway loadout system. The control can increase the amount of coal loaded in each rail car to the maximum limit. Developed by preparation plant personnel, the system replaces a temporary test unit built in 1977 and is expected to reduce rail costs by minimizing dead freight charges. A coal leveller to profile the load prior to spraying with a dust suppressant was also installed. This will minimize dust emission from trains en route to Roberts Bank.

Construction of a new high-energy scrubber to reduce dust emission from the preparation plant dryer began during 1978 and is scheduled for installation in the summer of 1979.

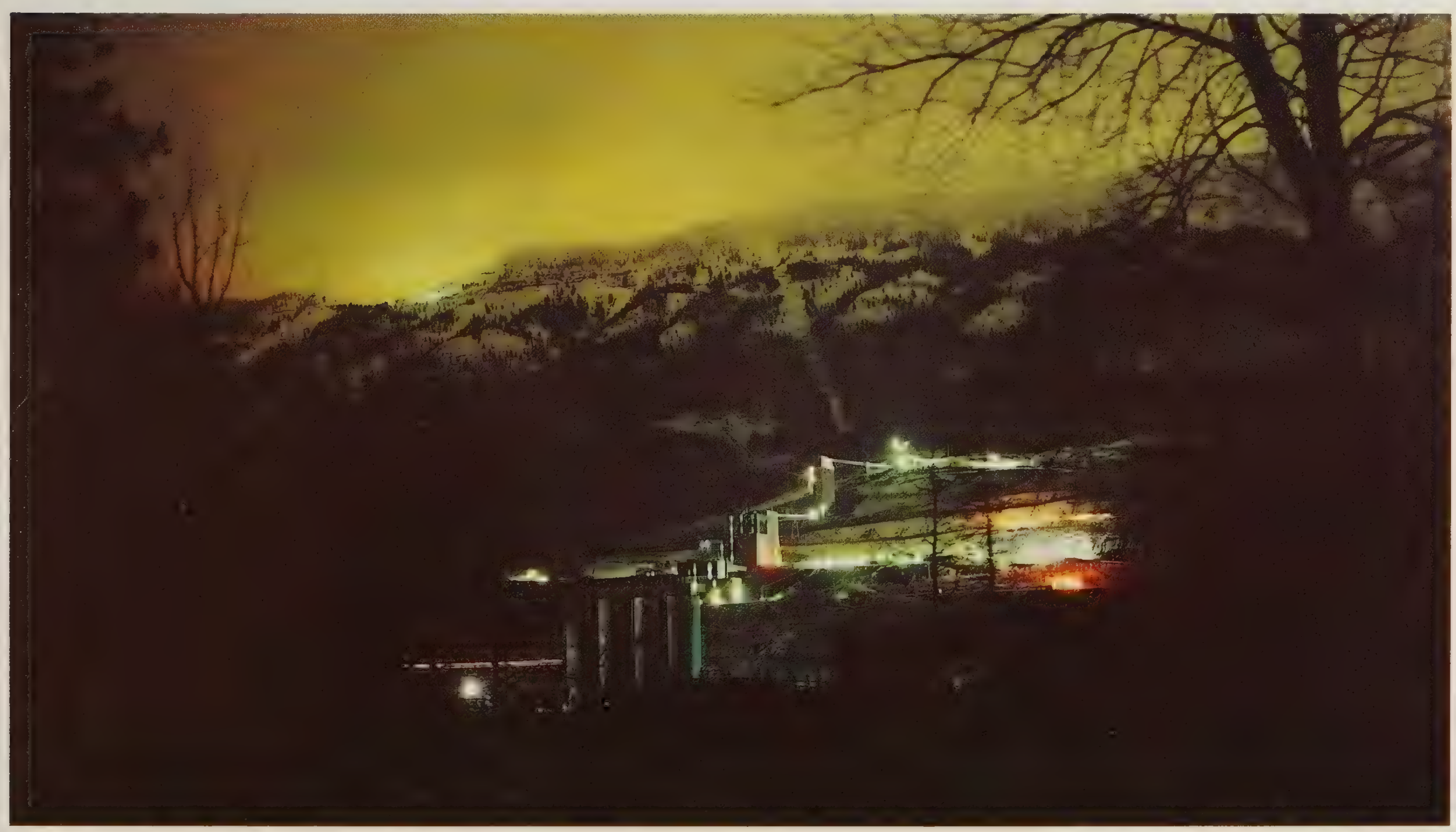
Employees

Exceptional performances by employee teams in British Columbia mine rescue competitions in 1978 achieved first place honors in both the surface and underground competitions. Teams are made up of volunteers who study and practice measures to be taken in the event of mining emergencies.

The surface mine rescue team responded to three civil emergencies in southeastern British Columbia during the year, including two mountain rescue operations.

A three-year collective agreement, retroactive to January 1, 1977, was reached during the second quarter of 1978 with Local 7292 of the United Mine Workers of America, representing approximately 1,400 hourly-paid production and maintenance employees. A two-year collective agreement, retroactive to January 1, 1978, was also reached with the Office and Technical Employees Union, representing 136 employees at Sparwood.

A three-year collective agreement, effective February 1, 1979, was reached with one of three locals of the International Longshoremen's and Warehousemen's Union which represents employees at the port of Roberts Bank. Negotiations for collective agreements with the two remaining locals are presently underway.



The Environment

The Coal Division was awarded the British Columbia Mine Reclamation Award by the provincial Ministry of Energy, Mines and Petroleum Resources for leading the mining industry in the reclamation of industrially disturbed land. It was the second time in three years that the Division received the award for its continuing leadership in the development and application of reclamation technology. Since 1970, approximately 2,000 acres of land have been reclaimed, which is about half the acreage currently occupied by active mining.

Reclamation projects during the year included beautification work in and around the former townsite of Natal where 72 acres were cleaned of refuse, seeded in grass, and planted with trees. This program to enhance the appearance of the area will continue in 1979. Reclamation work on 200 acres of dormant mine workings and 200 acres of exploration areas is also planned for the current year.

The economic viability of replacing the Division's Michel Valley coke ovens with modern facilities is being assessed. The coke ovens and coal screening facilities at Michel, which were constructed more than 40 years ago and purchased by Kaiser Resources in the late 1960's, are not in compliance with published provincial environmental objectives.

The Company has advised the British Columbia Ministry of the Environment that it is proceeding with plans to phase out screening and drying facilities at Michel and will transfer thermal coal loading activities to the Elkview preparation plant rail loop.

Terminals and Transportation

More than nine million tons of coal and coke were loaded aboard ships during 1978 by Westshore Terminals Ltd., a wholly-owned subsidiary which operates the port of Roberts Bank, south of Vancouver. The total tonnage, a record for the port, represented an increase of one million tons over 1977 shipments and included 3.5 million tons of product handled for other companies.

During the year, 148 ships called at Roberts Bank to take on cargoes bound for the Far East, Central and South America and Europe. Among them was the largest vessel ever to enter the port of Vancouver, the 168,392-ton Bristol Maru. Westshore employees loaded the Japan-bound freighter with 128,620 tons of coal in a record 42½ hours.

The first contract to ship Alberta coal through Westshore Terminals' port facilities was signed in 1978 with Luscar Ltd. of Edmonton. It provides for the shipment of approximately 10 million tons of thermal coal over a 15-year period from June 1, 1978.

The additional tonnage increases the port's throughput to near capacity levels. Westshore will expedite plans to install additional coal handling facilities on a proposed 50-acre site, providing the National Harbours Board proceeds with plans to expand the port on the basis of a recommendation by a federal environmental assessment panel.

Total Coal Shipped from Port

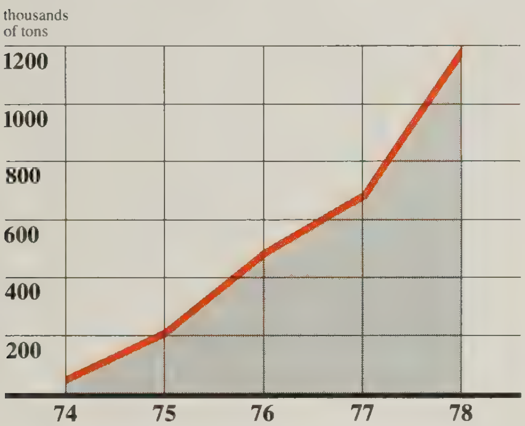
An example of progressive reclamation at the Sparwood operations. Reclamation is carried out after mining areas become dormant. The area in the foreground of this photograph will be one of the next targets for reclamation crews.

Marketing

Shipments of coal, coke and related products totalled a record 5.7 million tons in 1978 as the Coal Division continued to benefit from its program to diversify markets geographically. The total compares with 1977 shipments of 5.5 million tons.

Metallurgical coal shipments increased 6.8 percent to 5.2 million tons despite continuing soft market conditions in Japan, the Division's primary customer.

Metallurgical Coal Shipments to Countries other than Japan



In 1978, shipments of metallurgical coal to Japan totalled 4.0 million tons or 85 percent of the annual contract quantity, down slightly from 1977 shipments of 4.2 million tons or 88 percent of contract. The contract extends to 1985 and provides for annual sales of 4.75 million tons, plus or minus five percent at the buyer's option.

Customers in countries other than Japan accepted metallurgical coal deliveries totalling 1.2 million tons, a 70 percent increase over 1977 shipments of 696,000 tons.

The dramatic increase in shipments to countries other than Japan was attributable to increased shipments under long-term contracts with customers in Korea and Brazil, and the start of shipments under a new contract with Romania.

Trial cargoes to new customers in various areas of the world also contributed to the high shipment levels. The volumes of these additional shipments were favourably influenced by strike actions in the United States and Australia which disrupted coal deliveries from major producers. Sales efforts during this temporarily strong market period led to new contracts in Italy, Sweden and Spain.

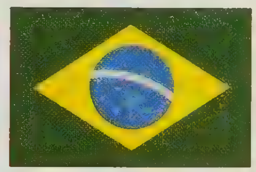
In the fourth quarter of 1978, metallurgical coal shipments to Mexico were resumed. Shipments had been suspended in October of 1977 as a result of a Mexican government order requiring the use of domestic coal. The contract that was to have expired in early 1979 was renegotiated and provides for the shipment of 285,000 metric tons through December 31, 1982.

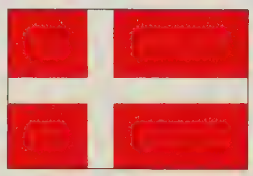
The Division expects to begin shipments to Pakistan later this year under its long-term contract signed in 1978.

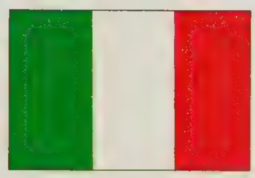
Demand for thermal coal continues to strengthen. The Division renegotiated its thermal coal contract with Denmark to cover shipments through 1979 and is pursuing several new opportunities.

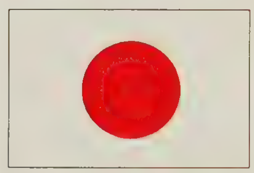
It took 11 tugs to ease the Bristol Maru into her berth at Roberts Bank early on a summer morning in 1978. Westshore Terminals loaded the ship, the largest ever to enter the port of Vancouver, in record time.

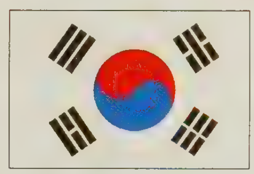

Canada

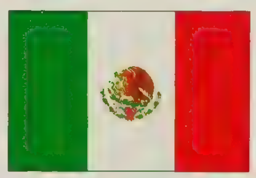

Brazil

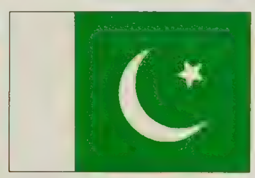

Denmark


Italy


Japan

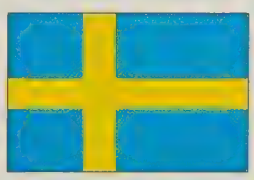

Korea

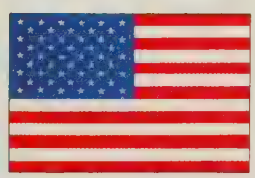

Mexico


Pakistan


Romania


Spain


Sweden


U.S.A.

Operations Review

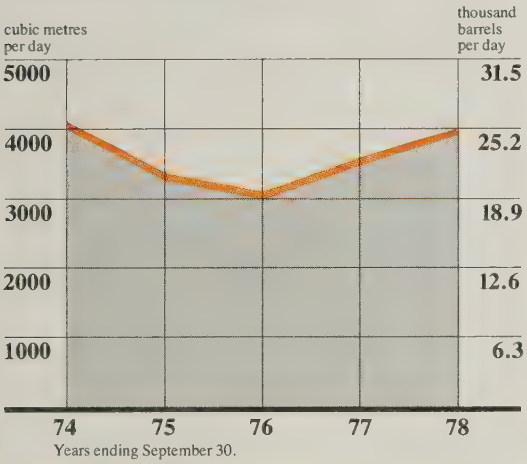
The Oil and Gas Division, headquartered in Calgary, is active in all facets of crude oil and natural gas exploration and development. Through a 25-year history of growth, the Division has developed substantial oil and gas reserves in Canada, strong holdings of petroleum and natural gas rights, and an able staff of 285 people. Of these, 180 people are directly involved in exploration, land acquisition, engineering and operations functions, while the remainder provide essential accounting, financial and administrative support.

The following report on oil and gas activities includes a number of metric measurements which the oil industry is adopting in 1979. A cubic metre of crude oil contains approximately 6.3 barrels (or 220 imperial gallons), a cubic metre of natural gas contains approximately 35 cubic feet, and a hectare of land is about 2.5 acres.

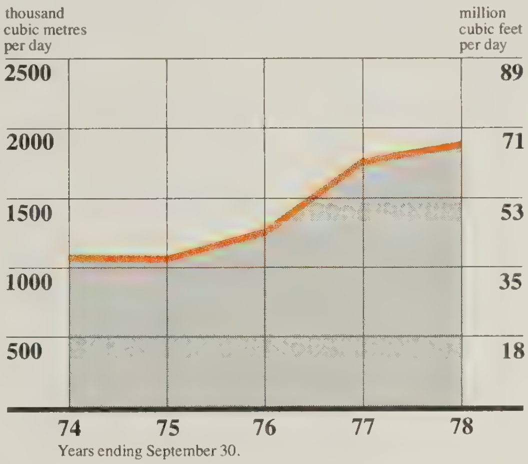
Reserves

Oil and gas reserves at December 31, 1978, as estimated by the Division's engineers, are detailed in the accompanying table. The table quotes "proven" and "probable" reserves separately. "Proven reserves" are those reserves which, to a high degree of certainty, are considered to be recoverable at commercial rates under present depletion methods and current operating conditions, prices and costs. "Probable additional" oil

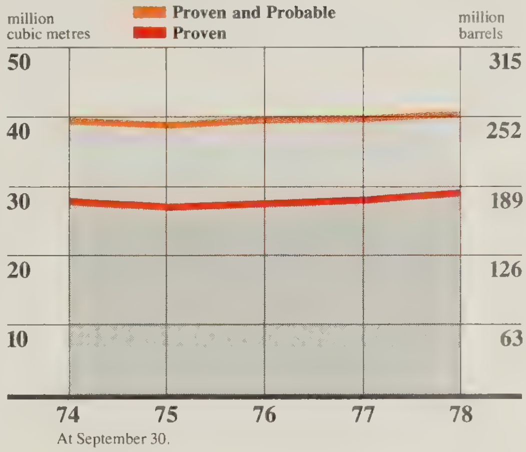
Crude Oil Production

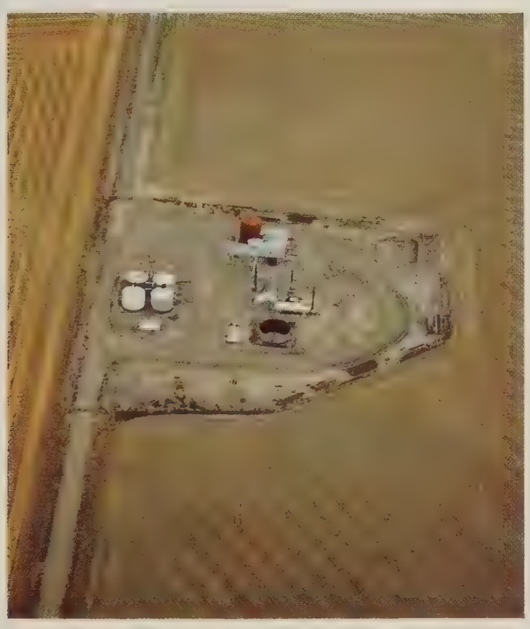


Natural Gas Production



Oil & Gas Reserves in Oil Equivalent





Facilities for processing and storing oil are familiar landmarks in wheat-growing regions of Alberta. This facility in the Taber South oil field also includes equipment for water injection which maintains reservoir pressures.

The Rocky Mountains of the Alberta Foothills (left) form the backdrop for a rig drilling at depths greater than two miles.

Production

Crude oil production averaged 4,300 cubic metres per day in the quarter ending December 31, 1978, an increase of 10 percent over production for the same period of the previous year. The higher oil production was attributable to well stimulation work, addition of high capacity pumps and infill drilling at the Grand Forks Lower Mannville "D" unit.

Gas production averaged two million cubic metres per day for the quarter, an increase of 11 percent over the same quarter in 1977, but substantially below volumes the Division is capable of producing should markets develop.

Reserves by Category	Dec. 31 **1978**	Sept. 30 1977
Crude oil and ngl — (thousand cubic metres)		
Proven developed	**14,500**	15,400
Probable additional	**8,300**	8,900
	22,800	24,300
Natural gas — (million cubic metres)		
Proven developed	**15,800**	13,900
Probable additional	**3,400**	3,400
	19,200	17,300
Total reserves in terms of equivalent oil* — (thousand cubic metres)		
Proven developed	**29,300**	28,500
Probable additional	**11,500**	12,100
Total reserves	**40,800**	40,600

*1064 cubic metres of natural gas are equivalent to 1 cubic metre of crude oil.

reserves are those reserves considered to be commercially recoverable as a result of beneficial effects which may be derived from future institution of some form of enhanced recovery scheme or as a result of more favourable performance of existing recovery mechanisms than that which could be deemed to be proven. The "probable additional" gas reserve figures are based on those areas of natural gas reservoirs which could not be deemed proven, but are potentially productive.

Exploration and Development

The Division has broad representation in petroleum and natural gas rights in Western Canada and frontier areas. These holdings, comprising interests in 4.5 million gross hectares, provide a strong base for future exploration and development. Key holdings in northwestern Alberta and British Columbia are detailed on the accompanying map.

An active drilling program was conducted during the quarter ending December 31, 1978. The Division participated in drilling 45 working interest wells which resulted in nine oil completions, 27 gas completions and nine dry holes. In addition, three gas wells, two oil wells and four dry holes were drilled by others on Division lands under farmout arrangements.

The Division is involved in a number of exploration and development programs, the most significant of which are summarized as follows:

Deep Basin Area

In the Elmworth gas trend of the Deep Basin area of Alberta, the Division has developed a significant position in petroleum and natural gas rights. Geophysical surveys and exploratory drilling will be carried out during 1979.

In the Gold Creek sector of the gas trend, an exploratory well was completed as a gas well early in 1978, and further petroleum and natural gas rights were acquired. Several exploratory wells are planned in 1979.

The Deep Basin area lies in northwestern Alberta, running into British Columbia. It has potential for significant gas production, but costs will be high because of difficult terrain and expensive completion techniques required in the recovery of gas from low permeability reservoirs. However, it appears that the Elmworth gas trend holds good potential for future economic production.

Jeans

In the Jeans area of British Columbia, a drilling program was maintained through most of 1978 to develop gas reserves and production on an approximate 4,000 hectare block of leases. The drilling success has been attractive, and it is expected that some gas production will be brought on stream in 1979. Further gas development will be conducted when it is warranted by increased demand.

West Pembina

In the West Pembina area of Alberta, the Division has acquired Crown licences evaluated through seismic techniques as having potential for significant oil reserves within the Nisku reef trend. These parcels remain to be tested by drilling. In addition, the Division has interests in a number of attractive leases, producing from a shal-

Petroleum and Natural Gas Rights
at December 31, 1978

	Thousand Hectares		Thousand Acres
	Gross	Net	Net
Alberta	1,880	821	2,052
British Columbia	242	92	229
Saskatchewan	88	56	139
Manitoba & Ontario	8	7	17
Fee Mineral Titles in Sask. & Manitoba	417	224	562
Canadian Frontier	1,815	209	522
Total Holdings	4,450	1,409	3,521

The Division has contracted the drilling crews of this big rig to explore deep zones. Continuous drilling requires three shifts of men who regularly work the 92-foot lengths of pipe in or out of the hole.

lower zone, which also have potential for Nisku reef production. A selective exploratory program is planned in this very competitive area.

Limestone

In the Limestone Mountain area, the location of a major deep gas discovery in 1975, the Division has interests which equate to 8,000 net hectares. The joint venture operator has announced plans to initiate a gas gathering system to tie the wells to an existing gas plant in late 1979. A reserves-based gas contract will be available in this area, with gas deliveries to start late in 1980. Participation is planned in at least two exploratory tests in the Limestone Mountain area in 1979.

Exploration drilling is being continued in the Majorville area of southern Alberta. The Division has established two oil pools and is evaluating the oil and natural gas potential of its extensive holdings in the area.

Heavy Oil

The Division has taken a 12.5 percent interest in an experimental project in the Suffield area of southeastern Alberta to test a method of recovering heavy crude oil. The $9 million project will evaluate "in situ" combustion as a method for recovery of heavy oil which lies at a depth of 1,000 metres. Information gained from the project will be applicable in several of the Division's heavy oil pools at Jenner, north of the Suffield test area.

Offshore

The Division holds a one percent net profits interest in four blocks in the Beaufort Sea and approximately one twelfth of Beaufort Exploration Limited which holds a two percent net profits interest in nine blocks and a one percent net profits interest in another block.

A 10 percent working interest has been earned in approximately 250,000 hectares in the Sable Island area, off Canada's east coast, by participation in the drilling of four exploratory wells. A well is currently being drilled on another 100,000 hectare block to earn a 10 percent working interest. Drilling results to date have not been favourable and no further activity is planned after completion of the current well.

Exploratory Regions — Western Alberta and British Columbia

A wholly-owned subsidiary owns a 1.4 percent interest in Blocks 16-3 and 16-7 and a 1.75 percent interest in Block 16-2 in the United Kingdom North Sea. A discovery on Block 16-7 has been named the Brae Field. Since the Division acquired its interest, five exploratory wells have been drilled as dry holes or have been deemed to be non-commercial. However, Brae well number 8, drilled in 1977, encountered a significant oil column in the south sector of Block 16-7.

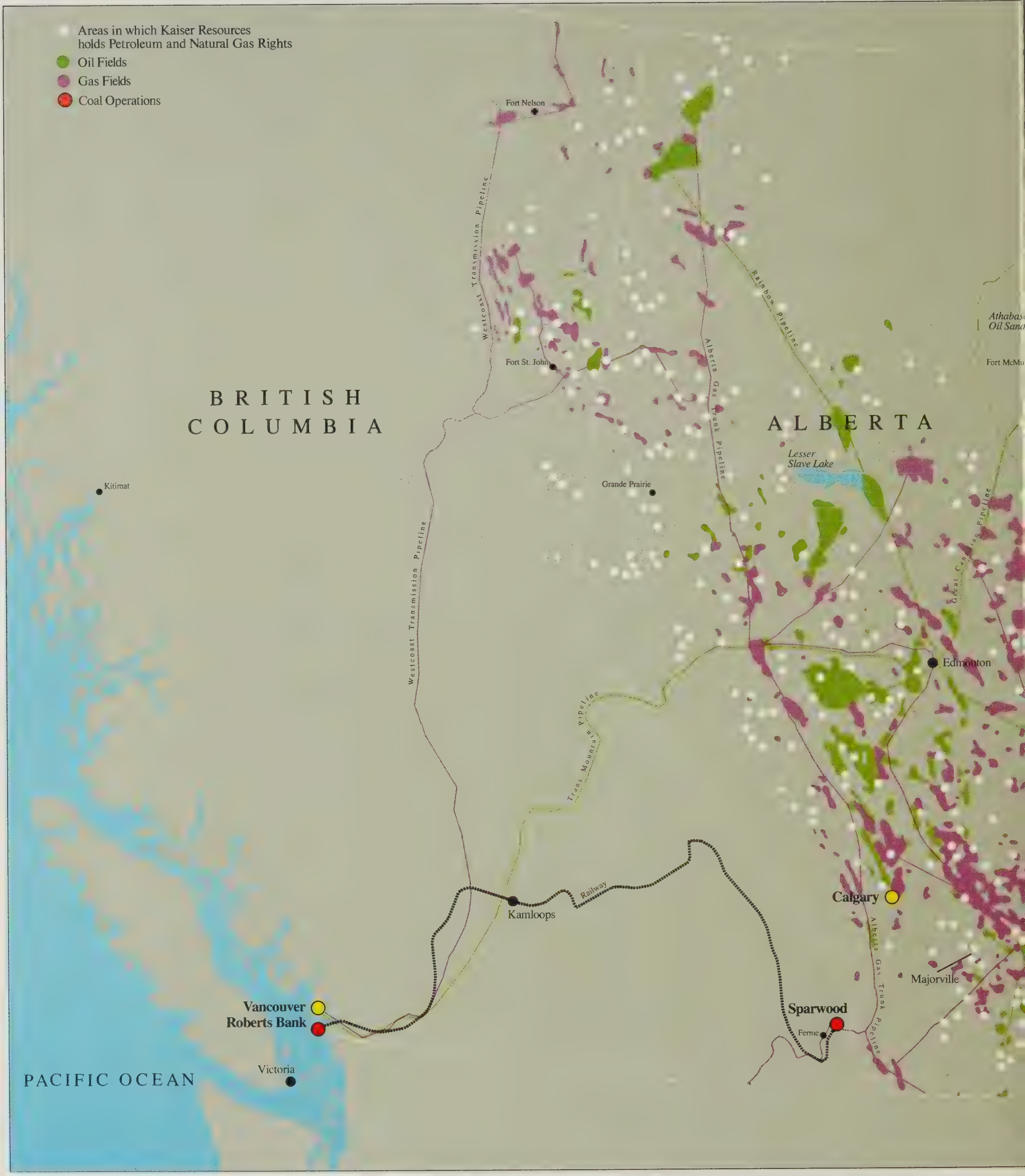
Delineation drilling of four additional wells surrounding the Brae number 8 discovery indicates a major accumulation. This accumulation is currently proposed for development, using a 30-36 slot production platform facility. Design studies are being conducted by the operator and an application will be made to the British government for approval to proceed with the proposed development, with the objective of bringing the Brae Field on production by 1984.

Asphalt Paving & Materials

The Asphalt Paving & Materials group, the largest operation of its kind in Canada, is headquartered in Toronto. Through five regional offices, the group operates 20 companies across Canada, and is active in seven provinces and 40 major cities and towns. Operations include asphaltic concrete paving, road construction, installation of municipal services, production and sale of asphaltic concrete and granular materials, as well as some bridge work and related construction.

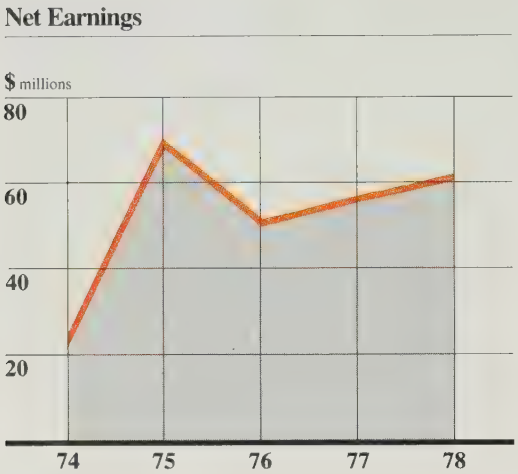
There are signs of increased construction activities in 1979 in the provincial-municipal sector and in energy-related projects in Alberta and British Columbia. Contract work remaining to be completed at December 31, 1978 amounted to $24 million.

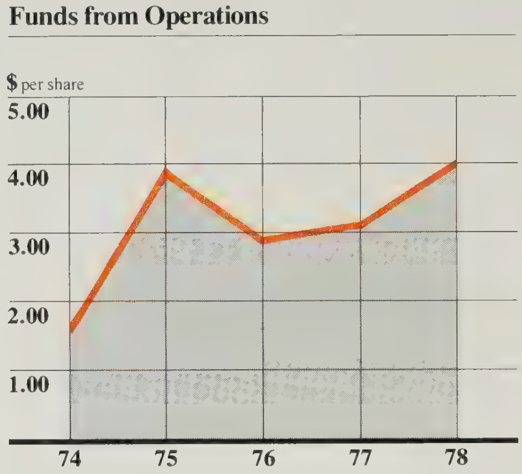
Area of Operations

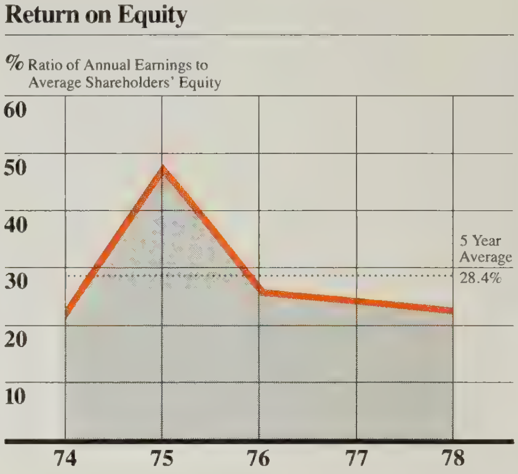


BEAUFORT SEA
Nektoralik K-59
Kopanoar M-13
Nerlerk J-88
Ukalerk C-50
Mackenzie Delta
0 MILES 50
0 KILOMETRES 80
Net Profit Interests
Oil Fields
Gas Fields
NOVA SCOTIA
ATLANTIC OCEAN
Sable Island
0 MILES 50
0 KILOMETRES 80
Working Interest Acreage
NORTH SEA
Forties
Brae
Piper
U.K.
0 MILES 100
0 KILOMETRES 160
Oil Fields
Oil Pipelines
SASKATCHEWAN
MANITOBA
Lake Winnipeg
Lake Winnipegosis
Lake Manitoba
Interprovincial Pipeline
Jenner
Trans Canada Pipeline
Regina
Winnipeg
Grand Forks
CANADA
UNITED STATES
0 MILES 50 100 150
0 KILOMETRES 80 160 240

Financial Summary







Net Earnings

Consolidated net earnings in 1978 totalled $62.1 million, an improvement of $4.8 million or eight percent over 1977 net earnings of $57.3 million. Earnings per share were $2.32, compared with $2.14 in 1977, calculated on the basis of a weighted average of 26.8 million shares outstanding in both years. The improvement in net earnings resulted primarily from a record level of coal shipments, higher coal prices and three months of business activity resulting from the acquisition of Ashland Oil Canada Limited.

Oil and Gas Acquisition

Kaiser Resources acquired 79 percent of the outstanding shares of Ashland Oil Canada Limited on October 3, 1978. On November 9, 1978, Kaiser Resources issued a tender offer for the remaining shares outstanding at $33.50 per share, the same price as that paid for the purchase of the initial control block. As a result, the Company's ownership interest increased to 97 percent at December 31, 1978 and through subsequent actions was increased to 100 percent by April 18, 1979.

Cost of shares acquired to December 31, 1978 amounted to $465.5 million. Cost of acquiring all of the shares was approximately $480 million. Of this amount, $322.5 million was borrowed from four Canadian banks and the remainder was provided from cash balances on hand.

Allocation of Purchase Price

The excess of the total price paid for the shares of Ashland Oil Canada Limited over the book value of the shares reflected in that company's accounts was allocated to the underlying assets purchased. The excess, or purchase premium, was allocated to reserves of crude oil and natural gas and to undeveloped oil and gas properties to effectively state those assets at fair market value.

The determination of fair market value was accomplished with the aid of outside consultants. The crude oil and natural gas reserves were valued at the net present value of the future income from producing properties. The value of undeveloped land was determined on the basis of current prices paid for acreage in the vicinity of land held by the company. These values were then reduced, to reflect the non-deductibility of the purchase premium amortization for tax purposes, to arrive at fair market value.

The purchase premium will be amortized on the same basis as the underlying assets to which it has been assigned. The annual charge to earnings for amortization will depend upon the rate at which reserves are extracted and the success achieved in locating oil and gas reserves on undeveloped properties. Based upon current estimates, the purchase premium amortization will amount to approximately $18 million per year.

Interest Income

Interest income earned from the investment of corporate cash balances amounted to $9.8 million in 1978, compared with $8.7 million in 1977. The increase resulted from higher interest rates and the inclusion of interest earned by the Oil and Gas Division in the last quarter of 1978.

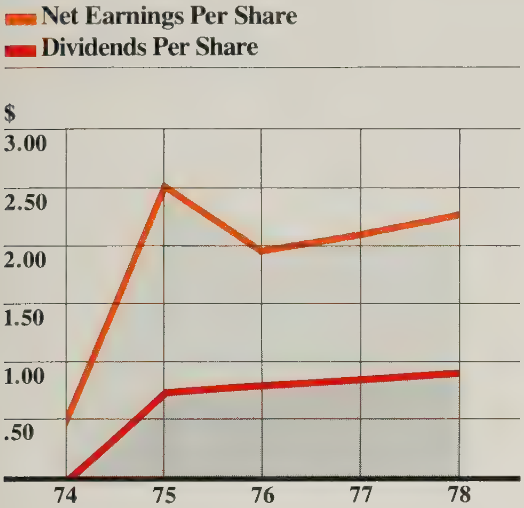
Taxes

The Company contributes significant amounts of taxes and royalties to federal, provincial and municipal governments in Canada. Details for 1978 and 1977 are shown below:

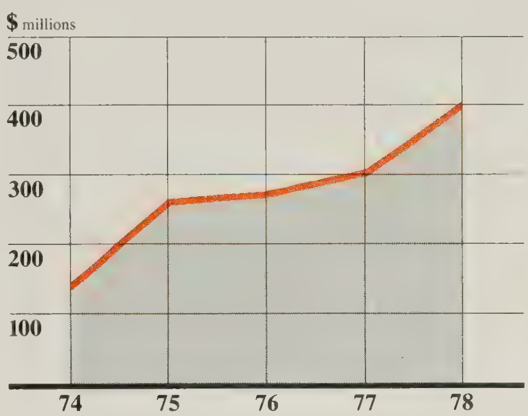
	(Millions)	
	1978	1977
Income and mining taxes	**$ 76.4**	$ 68.8
Export tax on crude oil	**8.3**	—
Crown royalties on oil and gas	**11.5**	—
Mineral land taxes	**7.4**	7.4
Property taxes	**2.7**	2.1
Corporation capital taxes	**.2**	.5
Total	**$106.5**	$ 78.8

The principal reason for the increase in taxes relates to the inclusion of the operations of the Oil and Gas Division for the last quarter of 1978.

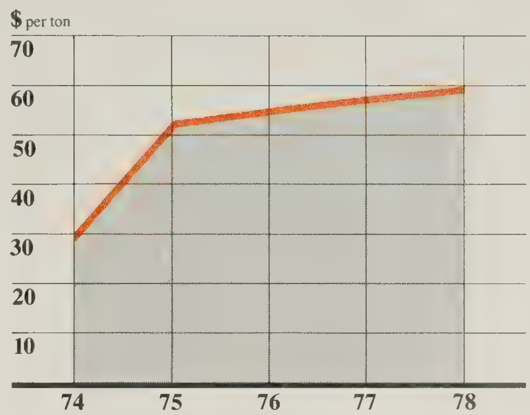
The effective tax rate for the Company was 54.4 percent in 1978, compared with 54.6 percent in 1977. Amortization of the purchase premium, paid in connection with



Revenue



Metallurgical Coal Price



the acquisition of Ashland Oil Canada Limited, is not a deductible expense for tax purposes. This will tend to increase the effective tax rate in future years.

Funds from Operations

Funds provided by operations in 1978 were $108 million, compared with $84.7 million in 1977. The increase is accounted for by the inclusion of the oil and gas and asphalt paving and materials operations for the fourth quarter of 1978 and the increased level of coal shipments for the year. Funds provided by operations are expected to continue to improve and will strengthen the Company's position to develop its existing business and pursue new opportunities.

Long-Term Debt

The Company borrowed $322.5 million from four Canadian banks to finance the acquisition of Ashland Oil Canada Limited. All loans are denominated in Canadian currency and are repayable in 28 equal quarterly instalments commencing June 30, 1982. Interest will be based on the Canadian prime rate until the end of 1979, increasing in progressive steps to 1¼ percent over prime, effective January 1, 1986. Prepayment is permitted without penalty at any time during the term of the loans.

Dividends

The quarterly dividend was increased in December of 1978 to 25 cents from 22½ cents per common share. This was the fourth increase since the initial dividend of 15 cents per share was paid in the first quarter of 1975. Dividends paid in 1978 amounted to $24.8 million or 40 percent of net earnings, compared with $23.3 million or 41 percent in 1977.

Coal

	(Thousands)
Revenue	$341,179
Operating profit before interest and taxes	139,157
Capital expenditures	23,363
Total Assets	203,946

Revenue from coal operations rose to a record $341.2 million, compared with the previous high of $307.7 million in 1977. The increase resulted from a higher level of metallurgical coal shipments at higher prices.

Total shipments of coal, coke and related products in 1978 were 5.7 million tons, compared with 5.5 million tons in 1977. Deliveries of metallurgical coal increased by 333,000 tons or seven percent.

Approximately 70 percent of the coal revenue in 1978 was derived from shipments to Japan. This compared with 77 percent in 1977. Virtually all of these shipments consist of metallurgical coal used in the production of steel, delivered under a contract with Mitsubishi Corporation. The contract extends through March 31, 1985.

An amendment to the contract effective April 1, 1978 increased the price of coal to $59.60 per ton for the two years ending March 31, 1980 and provides that no price adjustments for escalation will be allowed during that period. The contract amendment also provides for renegotiation of the price to be effective April 1, 1980, subject to binding arbitration if the parties are unable to agree.

The contract calls for delivery of 4.75 million tons of metallurgical coal per year, plus or minus five percent at the buyer's option. Shipments in recent years have been below the nominal contract level due to production curtailments in the Japanese steel industry.

Property, plant and equipment purchases in the coal operations amounted to $23.4 million in 1978. Of this amount, $9.9 million was spent for the development of the hydraulic mine, $1.2 million was expended for the purchase of a 350-ton Terex Titan truck and $12.3 million was spent for replacements of and improvements to equipment and facilities.

Capital expenditures in 1979 are expected to total approximately $29 million. Of this amount, approximately $9 million will be spent to complete the $49 million expansion program of the hydraulic mine, $6 million will be spent on a central warehouse and new general office facility at Sparwood, and $14 million will be applied to general improvements and replacements of equipment and facilities.

Oil and Gas

	(Thousands)
Revenue	$ 26,979
Operating profit before interest and taxes	7,279
Capital expenditures	18,474
Total Assets	565,081

Operating results from date of acquisition October 3, 1978.

Revenues from the oil and gas operations for the three months ended December 31, 1978 amounted to $27 million. Of this amount, 68 percent was earned from the sale of crude oil, 24 percent from natural gas and eight percent from interest and miscellaneous income. The average selling price during the period was $11.81 per barrel for crude oil and $1.43 per thousand cubic feet for natural gas.

In Alberta, crude oil production derived from Crown lands is sold to the Alberta Petroleum Marketing Commission, a Crown agency. Other oil production in Alberta and oil production in other provinces is sold directly to refiners. Natural gas production is generally sold under long-term contracts to gas transmission companies.

The Government of Canada regulates the price of crude oil and natural gas in interprovincial and international trade. The government has announced its intention to permit Canadian oil prices to increase gradually toward international levels. The current schedule calls for an increase of $1.00 per barrel on July 1, 1979 and a further $1.00 increase on January 1, 1980. Substantial portions of these increases accrue to governments, rather than to producers, because of royalty rates and other levies.

The price for natural gas in Canada is established at the price of gas delivered to Toronto City Gate, which at present is $2.00 per thousand cubic feet, less cost of transporting the gas from the point of sale to Toronto. Exports of natural gas are currently priced at U.S.$2.16 per thousand cubic feet. The National Energy Board has determined that Canada's reserves of natural gas are sufficient to permit increased exports to the United States. The export price will increase to U.S. $2.30 per thousand cubic feet on May 1, 1979. The additional revenues generated from the difference between domestic prices and export prices are prorated among all producers on the basis of each producer's share of gas production.

During the last quarter of 1978, the Oil and Gas Division spent approximately $3 million on acquisition of properties, $8.4 million on exploration activities and $5.2 million on development activities. It is expected that approximately $48 million will be spent on land acquisitions, exploration and development during 1979.

The Company follows the "successful efforts method" of accounting for its oil and gas activities. The effect of this method is to capitalize only those costs which can be directly related to future economic benefits.

Asphalt Paving & Materials

	(Thousands)
Revenue	$39,035
Operating profit before interest and taxes	4,341
Capital expenditures	330
Total Assets	77,184

Operating results from date of acquisition October 3, 1978.

Revenues from the asphalt paving and materials business amounted to $39 million in the three months ended December 31, 1978.

The asphalt paving and materials operations are geographically dispersed throughout Canada. The business is seasonal in nature and highly competitive. Substantially all of the asphalt paving and construction activities result from successful competitive bidding on projects offered for public tender by Canadian federal, provincial and municipal governments and by commercial and industrial enterprises.

Capital expenditures in the asphalt paving and materials business were $330,000 in the last quarter of 1978. Capital expenditures in 1979 are expected to total $9 million due primarily to the replacement of a major plant in Eastern Canada.

Consolidated Statement of Earnings

For the years ended December 31, 1978 and 1977

	(Thousands)	
	1978	1977
Revenue:		
Coal (Note L)	**$333,921**	$299,005
Oil and gas	**25,680**	—
Asphalt paving and materials	**39,035**	—
Interest and other income, net	**9,530**	8,722
	408,166	307,727
Costs and expenses:		
Cost of products and services sold	**203,570**	147,900
General and administrative	**25,386**	18,294
Exploration and related costs	**9,629**	2,020
Interest on long-term debt	**8,403**	864
Depreciation, depletion and amortization	**20,820**	12,520
	267,808	181,598
Earnings before provision for income taxes and minority interest	**140,358**	126,129
Provision for income taxes (Note I)	**76,381**	68,847
Minority interest	**1,833**	—
Net earnings	**$ 62,144**	$ 57,282

Net earnings per share (Note J)	**$ 2.32**	$ 2.14

Consolidated Balance Sheet
As at December 31, 1978 and 1977

Assets	(Thousands)	
	1978	1977
Current assets:		
Cash and term deposits	**$ 14,751**	$104,525
Short-term investments, at cost which approximates market	**31,889**	—
Accounts receivable	**100,045**	14,913
Inventories (Note C)	**38,542**	32,893
Prepaid expenses	**3,588**	1,244
	188,815	153,575
Property, plant, equipment and related development costs, at cost: (Note L)		
Coal	**248,040**	234,303
Oil and gas	**476,232**	5,000
Asphalt paving and materials	**38,777**	—
Other	**14,609**	6,113
	777,658	245,416
Accumulated depreciation, depletion and amortization	**114,510**	95,759
	663,148	149,657
Other assets	**14,703**	9,523
	$866,666	$312,755

Consolidated Statement of Shareholders' Equity
For the years ended December 31, 1978 and 1977

	Capital Stock			
	Shares Issued	Amount	Contributed Surplus	Retained Earnings
		(Thousands)		
Balance January 1, 1977	26,751,855	$ 26,752	$ 74,390	$109,803
Net earnings — 1977				57,282
Exercise of options	57,850	58	441	
Dividends ($.87 per share)				(23,315)
Balance December 31, 1977	26,809,705	26,810	74,831	143,770
Net earnings — 1978				62,144
Exercise of options	26,050	26	289	
Dividends ($.925 per share)				(24,813)
Balance December 31, 1978	26,835,755	$ 26,836	$ 75,120	$181,101

Liabilities and Shareholders' Equity

	(Thousands)	
	1978	1977
Current liabilities:		
Accounts payable and accrued liabilities	**$ 97,453**	$ 17,370
Income taxes payable	**23,969**	10,388
Long-term debt due within one year	**104**	—
	121,526	27,758
Deferred production income	**1,216**	—
Long-term debt (Note D)	**352,956**	—
Deferred income taxes	**102,435**	39,586
Minority interest	**5,476**	—
Shareholders' equity:		
Capital stock (Note E)		
Authorized — 28,000,000 common shares of par value $1 each		
Issued and fully paid	**26,836**	26,810
Contributed surplus	**75,120**	74,831
Retained earnings	**181,101**	143,770
	283,057	245,411
Commitments and contingencies (Note F)		
	$866,666	$312,755

Approved by the Directors: Howard E. Cadinha, *Director* E.D.H. Wilkinson, Q.C., *Director*

Auditors' Report

The Shareholders,
Kaiser Resources Ltd.

We have examined the consolidated balance sheet of Kaiser Resources Ltd. as at December 31, 1978 and 1977 and the consolidated statements of shareholders' equity, earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the Company as at December 31, 1978 and 1977 and the results of its operations and the changes in its financial position for the years then ended, in accordance with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Touche Ross & Co.
Chartered Accountants

Vancouver, British Columbia
January 24, 1979

Consolidated Statement of Changes in Financial Position

For the years ended December 31, 1978 and 1977

	(Thousands)	
	1978	1977
Source of funds:		
Net earnings	**$ 62,144**	$ 57,282
Depreciation, depletion and amortization	**20,820**	12,520
Deferred income taxes	**23,239**	14,864
Minority interest	**1,833**	—
Funds provided by operations	**108,036**	84,666
Addition to long-term debt	**322,507**	—
Capital stock issued	**315**	499
Other	**712**	1,145
Total source of funds	**431,570**	86,310
Application of funds:		
Acquisition of subsidiary, net of working capital (Note B)	**421,187**	—
Additions to property, plant, equipment and related development costs	**43,953**	33,542
Reduction of long-term debt	**145**	4,785
Dividends paid	**24,813**	23,315
Other	**—**	1,231
Total application of funds	**490,098**	62,873
Increase (decrease) in working capital (see below)	**(58,528)**	23,437
Working capital at beginning of year	**125,817**	102,380
Working capital at end of year	**$ 67,289**	$125,817
Summary of increase (decrease) in working capital:		
Cash and term deposits	**$ (89,774)**	$ (4,839)
Short-term investments	**31,889**	—
Accounts receivable	**85,132**	6,714
Inventories	**5,649**	(5,885)
Prepaid expenses	**2,344**	11
Accounts payable and accrued liabilities	**(80,083)**	(2,309)
Income taxes payable	**(13,581)**	22,822
Long-term debt due within one year	**(104)**	6,923
	$ (58,528)	$ 23,437

Notes to the Consolidated Financial Statements

December 31, 1978 and 1977

Note A — Summary of Significant Accounting Policies

Accounting Principles:

The Company is incorporated under the Companies Act of the Province of British Columbia and prepares its accounts in accordance with generally accepted accounting principles followed in Canada.

Principles of Consolidation:

The consolidated financial statements include the accounts of all subsidiaries. The principal subsidiaries are Ashland Oil Canada Limited and Westshore Terminals Ltd. The accounts of Ashland Oil Canada Limited are consolidated from the date of acquisition under the purchase method of accounting.

Inventories:

Product inventories are valued at the lower of average cost and net realizable value. Inventories of operating supplies are valued at average cost. Depreciation, depletion and amortization of preproduction and development costs are not included in product inventory costs.

Property, Plant, Equipment and Related Development Costs:

Acquisition costs of coal-bearing lands are capitalized and depleted over the expected recovery of coal from the property by the unit of production method. Coal exploration costs are charged against earnings when incurred. Costs incurred in connection with feasibility studies for new mining projects are capitalized and charged against earnings over the life of the mine or written off when the project is proven unfeasible. Preproduction and development costs are capitalized and amortized on the straight-line basis over the life of each mine.

Costs incurred in crude oil and natural gas activities are accounted for under the successful efforts method. Costs of acquiring exploration rights on oil and gas properties are capitalized. A provision for impairment in value of undeveloped properties is made against earnings at an increasing rate each year over the period of the exploration rights based on experience. When an undeveloped property is surrendered, the original cost of the property is charged against the accumulated provision for impairment. If the cost of properties surrendered exceeds the accumulated provision for impairment, the excess is charged against earnings. When an undeveloped property is proven to be productive, the original cost is transferred to developed properties and amortized by the unit of production method over estimated proven reserves.

Exploration expenditures, including geological and geophysical costs, annual rentals on undeveloped properties and drilling costs of exploratory dry holes are charged against earnings. Costs of drilling successful wells and other development costs are capitalized as developed properties and amortized by the unit of production method over estimated proven reserves.

Plant and equipment used in all activities is depreciated on the straight-line basis over the estimated useful life of each asset for periods up to 25 years, except for oil and gas production equipment which is depreciated by the unit of production method.

Expenditures for repairs and maintenance of plant and equipment are charged against earnings. Replacements and major improvements are capitalized. Costs of assets sold, retired or abandoned and the related amounts of accumulated depreciation are eliminated from the accounts. Gains or losses on such dispositions are included in earnings.

Revenue:

Revenue from asphalt paving contracts is recorded in the accounts under the percentage of completion method on the basis of work completed. Provision for losses is reflected in earnings when anticipated.

Pension Plans:

Annual contributions to employee pension plans are charged against earnings. Pension contributions are actuarially determined to include amounts necessary to provide for current service and for funding of past service liabilities over 15 years.

Income Taxes:

Income taxes are accounted for by the tax allocation method. Under this method, provision for taxes is made in the year transactions affect net income as opposed to when such items are recognized for tax purposes. Differences between the provision for taxes and taxes currently payable are reflected as deferred income taxes. Tax benefits resulting from allowances for frontier oil and gas exploration are deferred and reflected in earnings at the same time as the related exploration costs. Tax benefits from earned depletion are reflected as a reduction in the tax rate in the year claimed.

Note B — Acquisition of Ashland Oil Canada Limited

On October 3, 1978, the Company acquired 79% of the outstanding shares of Ashland Oil Canada Limited, which is engaged in the exploration and development of oil and gas properties and the asphalt paving business. On November 9, 1978, the Company offered to purchase the remainder of the outstanding shares at $33.50 per share, the same price as that paid for the purchase of the controlling interest, with the intent of making Ashland Oil Canada Limited a wholly-owned subsidiary. The offer will remain open until March 9, 1979, and is subject to extension by the Company. The purchase of shares as a result of the offer has increased the Company's ownership interest in Ashland Canada to 97% at December 31, 1978. At that date, 494,518 shares were held by the minority shareholders.

The acquisition has been accounted for under the purchase method of accounting. The excess of purchase price over the book value of net assets acquired has been allocated to the oil and gas properties.

The assets acquired are summarized as follows:

		(Thousands)
Property, plant and equipment:		
Oil and gas		$454,371
Asphalt paving and materials		38,770
Other assets		3,364
		496,505
Less: Long-term debt	$ 30,594	
Deferred income taxes	39,611	
Minority interest	5,113	75,318
Net assets		421,187
Working capital		44,285
Total purchase price and other acquisition costs		$465,472

If the 97% ownership interest in Ashland Canada had been acquired at the beginning of the year, the unaudited pro forma consolidated results for 1978 would have shown revenue of $559,200,000, net earnings of $55,400,000, net earnings per share of $2.07 and funds provided by operations of $125,000,000.

Note C — Inventories

	(Thousands) 1978	1977
Coal	**$ 11,978**	$ 17,180
Crude Oil	**2,095**	—
Asphalt paving materials	**8,883**	—
Operating supplies	**15,586**	15,713
	$ 38,542	$ 32,893

Amounts shown for operating supplies have been reduced by provisions for shrinkage and obsolescense of $1,311,000 in 1978 and $778,000 in 1977.

Note D — Long-Term Debt

	(Thousands) 1978
Bank loans, secured by shares acquired in Ashland Oil Canada Limited, at the prime rate of interest until December 31, 1979, at rates over prime of ¾% to December 31, 1982, 1% to December 31, 1985 and 1¼% to March 31, 1989, repayable in 28 equal quarterly installments commencing June 30, 1982.	**$322,507**
10⅜% sinking fund debentures due November 1, 1996, with annual sinking fund payments of $1,500,000 commencing November 1, 1981.	**30,000**
Other notes and mortgages	**553**
	353,060
Installments due within one year	**104**
	$352,956

Long-term debt maturities for the years 1979 through 1983 are $104,000, $103,000, $1,571,000, $36,111,000, and $47,621,000, respectively.

Note E — Capital Stock

The Company has a stock option program for officers and salaried employees. Options to purchase shares are exercisable for four years commencing one year after the date of grant. Option prices are based on the average of the high and low market prices of shares traded on the Toronto Stock Exchange on the date of grant. At December 31, 1978, there were options outstanding to purchase 329,850 shares at prices ranging from $4.45 to $16.00 per share through October 4, 1983. At December 31, 1977, there were options outstanding to purchase 217,050 shares.

Note F — Commitments and Contingencies

In 1974, the Company entered into an agreement with Mitsui Mining Company, Limited and Mitsubishi Corporation to conduct a feasibility study of a new mining project, on the Company's property, capable of producing up to approximately 2,000,000 long tons of clean metallurgical coal per year. As of December 31, 1978, the Company had invested $2,776,000 in Kaiser Coal Canada Ltd., the company incorporated for the purpose of conducting the study. If the parties decide to develop the project, the Company will be obligated to contribute 50% of the equity capital required in exchange for a 70% ownership interest. Development of the project has been delayed pending a strengthening of international markets for coal.

Note G — Remuneration of Directors and Senior Officers

The aggregate direct remuneration paid to directors and senior officers of the Company amounted to $1,411,000 for 1978 and $1,789,000 for 1977.

Note H — Pension Plans

The Company and its subsidiaries have pension plans for hourly and salaried employees. Contributions to these plans amounted to $1,732,000 for 1978 and $982,000 for 1977. Increased contributions for 1978 relate principally to increased benefit levels adopted in the hourly employee plans and to the inclusion of costs for pension plans of Ashland Oil Canada Limited from October 3, 1978. At December 31, 1978, the unfunded past service liability for all pension plans amounted to $6,795,000.

Note I — Provision for Income Taxes

	(Thousands)	
	1978	1977
Current:		
Federal and provincial income taxes	**$ 39,303**	$ 40,964
British Columbia mining tax	**13,839**	13,019
	53,142	53,983
Deferred:		
Federal and provincial income taxes	**21,343**	13,396
British Columbia mining tax	**1,896**	1,468
	23,239	14,864
	$ 76,381	$ 68,847

Deferred income taxes result from timing differences between the recognition of expenses for income tax and financial statement purposes and are summarized as follows:

	(Thousands)	
	1978	1977
Depreciation	**$ 11,465**	$ 9,985
Oil and gas exploration and development costs	**8,839**	2,550
Oil and gas frontier exploration allowances and depletion benefits	**3,571**	2,382
Other	**(636)**	(53)
	$ 23,239	$ 14,864

The difference between the composite of the statutory income tax rates for the Company and its subsidiaries and the effective tax rate is summarized as follows:

	1978	1977
Composite statutory federal and provincial income tax rate	**50.5%**	51.0%
Increase (decrease) resulting from:		
Non-deductible provincial mining taxes	**11.3**	11.5
Non-deductible royalties, mineral land taxes and other payments to provincial governments	**6.1**	2.1
Federal resource allowance	**(11.3)**	(8.8)
Earned depletion	**(1.6)**	(.9)
Other	**(.6)**	(.3)
Effective tax rate	**54.4%**	54.6%

Note J — Earnings Per Share

Earnings per share are calculated on the weighted average number of shares outstanding of 26,821,796 in 1978 and 26,792,441 in 1977.

Note K — The Impact of Inflation

The effect of inflation has been to increase the cost of operations. In the coal business, the Company has generally been able to recover such increases through price escalation provisions of its sales contracts. However, with the suspension of escalation protection in the principal sales contracts for the two years ending March 31, 1980, the Company's ability to reduce the impact of cost increases will be dependent on its ability to increase productivity and achieve higher shipment levels.

In the oil and gas business, the recovery of cost increases has largely been achieved through increases in energy prices which in Canada are increasing toward world levels. The ability to recover cost increases in the asphalt paving business is highly uncertain due to the intense competition in that industry.

Information on replacement cost for inventories, cost of sales, plant and equipment and related depreciation will be provided in the Company's annual report on Form 10-K which will be filed with the Securities and Exchange Commission, Washington, D.C., before April 25, 1979. A copy of the report may be obtained from the Company upon request.

Note L — Business Segments

	1978 (Thousands)					1977
	Coal	Oil and Gas	Asphalt Paving and Materials	Unallocated	Total	Total
Revenue:						
Export Japan	$237,775	$ —	$ —	$ —	$237,775	$237,091
Other	86,825	—	—	—	86,825	53,826
Domestic	9,321	25,680	39,035	—	74,036	8,088
Interest and other income, net	7,258	1,299	—	973	9,530	8,722
	341,179	26,979	39,035	973	408,166	307,727
Cost of products and services sold	167,702	4,093	31,775	—	203,570	147,900
General and administrative	18,961	2,097	1,475	2,853	25,386	18,294
Exploration and related costs	2,609	7,020	—	—	9,629	2,020
Depreciation, depletion and amortization	12,750	6,490	1,444	136	20,820	12,520
Operating profit	$139,157	$ 7,279	$ 4,341	$ (2,016)	$148,761	$126,993
Capital expenditures	$ 23,363	$ 18,474	$ 330	$ 1,786	$ 43,953	$ 33,542
Identifiable assets at year end — at cost:						
Developed properties and related development costs	$ 40,770	$333,945	$ 9,114	$ —	$383,829	$ 40,770
Undeveloped properties	—	138,727	—	—	138,727	5,000
Other properties	—	951	—	—	951	—
Plant and equipment	207,270	2,609	29,663	14,609	254,151	199,646
	248,040	476,232	38,777	14,609	777,658	245,416
Less: Accumulated depreciation, depletion and amortization	105,546	6,400	1,156	1,408	114,510	95,759
	$142,494	$469,832	$ 37,621	$ 13,201	$663,148	$149,657
Total assets	$203,946	$565,081	$ 77,184	$ 20,455	$866,666	$312,755

The oil and gas and asphalt paving segments reflect the Company's interest in the operations of Ashland Oil Canada Limited from October 3, 1978. Prior to that date, the Company had no significant operations other than its coal business.

Exports to Japan represent metallurgical and thermal coal sales under contracts with Mitsubishi Corporation. Substantially all of the sales to Mitsubishi result from shipments of metallurgical coal used in the production of steel. The metallurgical coal contract extends through March 31, 1985. An amendment to the contract effective April 1, 1978 established the price of coal at $59.60 per long ton for the two years ending March 31, 1980 and provided that no price adjustments for escalation would be allowed in that period. The contract amendment also provides for price renegotiations effective April 1, 1980 subject to binding arbitration if the parties are unable to agree.

Oil and gas revenue excludes royalties and excise taxes. Crude oil is purchased from other producers for resale to refiners. The excess of revenues over related costs for these transactions is reported as other income.

Note M — Quarterly Financial Data (Unaudited)

(Thousands Except for Share Statistics)

	1978 Quarters Ended				1977 Quarters Ended			
	Mar. 31	**June 30**	**Sept. 30**	**Dec. 31**	Mar. 31	June 30	Sept. 30	Dec. 31
Sales of products and services	**$77,411**	**$72,041**	**$101,533**	**$147,651**	$73,106	$81,799	$71,357	$72,743
Gross profit	**36,174**	**34,016**	**53,501**	**71,375**	37,855	41,859	37,155	34,236
Net earnings	**13,380**	**12,237**	**21,263**	**15,264**	14,513	16,172	13,591	13,006
Earnings per share	**$ .50**	**$ .46**	**$ .79**	**$ .57**	$ .54	$ .60	$ .51	$ .49
Dividends per share	**.225**	**.225**	**.225**	**.25**	.215	.215	.215	.225
Common stock price (Toronto Stock Exchange)								
High	**$14.88**	**$15.38**	**$16.50**	**$17.00**	$15.63	$15.63	$15.13	$14.50
Low	**12.88**	**14.25**	**14.00**	**14.50**	13.75	13.63	12.75	12.75

During the fourth quarter of 1978, mineral land taxes previously included under a separate expense caption in the statement of earnings were reclassified to cost of products and services sold. Accordingly, the gross profit for the previously reported periods has been restated.

Five-Year Review

(Thousands except per share data)	1978	1977	1976	1975	1974
Sales					
Coal — tons	**5,738**	5,478	4,954	5,593	5,459
Oil — barrels	**2,477**	—	—	—	—
Gas — mcf	**6,548**	—	—	—	—
Summary of Earnings					
Revenue:					
Coal	**$333,921**	$299,005	$262,890	$259,870	$142,597
Oil & Gas	**25,680**	—	—	—	—
Asphalt paving & materials	**39,035**	—	—	—	—
Interest and other income, net	**9,530**	8,722	11,732	5,564	3,997
Total	**408,166**	307,727	274,622	265,434	146,594
Cost of products and services sold	**203,570**	147,900	121,561	116,349	89,730
General and administrative	**25,386**	18,294	14,148	11,913	9,440
Exploration and related costs	**9,629**	2,020	1,049	1,123	457
Interest on long-term debt	**8,403**	864	1,548	2,535	5,875
Depreciation, depletion and amortization	**20,820**	12,520	16,401	15,261	14,444
Earnings before provision for income taxes, minority interest and extraordinary items	**140,358**	126,129	119,915	118,253	26,648
Provision for income taxes	**76,381**	68,847	67,528	54,253	13,986
Minority interest	**1,833**	—	—	—	—
Extraordinary items	—	—	—	7,229[1]	11,496[1]
Net earnings	**$ 62,144**	$ 57,282	$ 52,387	$ 71,229	$ 24,158
Weighted average number of shares outstanding	**26,822**	26,792	26,394	25,158	23,954
Share Statistics					
Basic earnings:					
Before extraordinary items	**$ 2.32**	$ 2.14	$ 1.98	$ 2.54	$ .53
Extraordinary items	—	—	—	.29	.48
Net earnings	**2.32**	2.14	1.98	2.83	1.01
Dividends	**.925**	.87	.815	.75	—
Book value at year end	**10.55**	9.15	7.89	6.85	4.99
TSE common stock price — high	**17.00**	15.63	16.38	12.75	5.38
— low	**12.88**	12.75	9.38	4.90	3.00
Other Financial Data					
Cash flow from operations	**$108,036**	$ 84,666	$ 77,922	$ 99,773	$ 40,907
Working capital	**67,289**	125,817	102,380	66,315	11,517
Capital expenditures	**43,953**	33,542	13,330	21,416	10,186
Total assets	**866,666**	312,755	295,646	261,869	163,511
Total long-term debt	**353,060**	—	11,708	18,980	28,738
Shareholders' equity	**283,057**	245,411	210,945	177,564	119,625
Shareholders at year end	**6,076**	6,398	6,455	5,390	3,957
Employees at year end	**2,730**	1,930	2,030	2,008	1,960

Note: [1]Reduction of income taxes otherwise payable due to the application of loss carry-forwards.

Management's Discussion and Analysis of the Summary of Earnings

1978 Compared With 1977

The inclusion of operating results of the Oil and Gas Division from October 3, 1978 caused significant variations in *revenue* and *expense*. The Division is engaged in the oil and gas and asphalt paving and materials business. Note L — to the Consolidated Financial Statements reflects the impact of the new business segments on the *revenues* and *expenses* for 1978. Prior to October 3, 1978, the Company had no significant operations other than its coal business.

Revenue increased by $100.4 million to $408.2 million. The acquisition of the new business segments accounted for $66 million of the increase. The remaining $34.4 million of the increase was principally due to higher metallurgical coal shipments at higher prices. Deliveries of metallurgical coal increased by 7%, as a result of continued success in securing new markets for coal outside of Japan. In 1978 approximately 70% of the coal revenue was derived from metallurgical coal delivered to Japan under a long-term contract with Mitsubishi Corporation, compared with 77% in 1977. The price for coal under this contract increased by $1.96 to $59.60 per ton during the year.

Costs and expenses increased by $86.2 million in 1978. The Oil and Gas Division's operations in the fourth quarter accounted for $51.3 million of the increase.

Cost of coal sold rose 13% during the year reflecting higher labour, material and rail freight costs and higher shipment levels. The increase in *general and administrative expenses* in the coal and unallocated segments related principally to higher salary and travel costs and higher costs for outside services associated with engineering and other studies.

Exploration and related costs increased due to the Company's participation throughout 1978 in offshore oil and gas exploration activities. Costs incurred in crude oil and natural gas activities are accounted for under the successful efforts method. Exploration expenditures, including geological and geophysical costs, annual rentals on undeveloped properties and drilling costs of exploratory dry holes are charged against earnings. Dry hole costs incurred in the Sable Island area of Canada's east coast amounted to $3.9 million.

The increase in *interest* resulted from long-term debt incurred in conjunction with the acquisition of Ashland Oil Canada Limited. The increase in the *provision for income taxes* was primarily due to higher earnings.

1977 Compared With 1976

Revenue increased by $33.1 million in 1977 to $307.7 million as a result of higher shipments and higher prices for metallurgical coal. Deliveries of metallurgical and thermal coal during the year increased by 8% and 55%, respectively, as a result of intensified efforts to secure new markets for coal outside of Japan. The price for coal under the Japanese contract increased by $2.55 to $57.64 per ton during the year as a result of price adjustments for escalation.

Interest and other income declined by $3 million during the year principally as a result of losses incurred on the disposal of equipment no longer required and lower interest earnings from the investment of cash balances due to declining interest rates.

Costs and expenses increased in 1977 primarily as a result of the effect of inflation, higher shipment levels and increased activities in the administrative areas to diversify markets and to evaluate new opportunities for future growth. *Cost of products sold* rose 25% during the year, reflecting the general impact of inflation on labour and materials costs, higher shipment levels and higher rail freight costs incurred to move coal to the Company's port facilities for sale in export markets.

The increase in *general and administrative expenses* related principally to higher salary costs, increased exploration activity on the Company's property and higher travel and related costs attributable to the increased activities of the Company. The decrease in *interest* resulted from the retirement of long-term debt during the year.

Reduced charges for *depreciation and depletion* are accounted for principally by the extension of the estimated useful lives of certain major facilities to 25 years from 15 years.

Prior Years

Coal revenue in 1976 increased slightly over the preceding year as the price increase for metallurgical coal shipped to Japan of $2.69 to $55.09 per ton was offset by a decline of 9% in metallurgical coal shipments. *Income taxes* rose by $13.3 million in 1976 as a result of higher federal and provincial income tax rates, and the decrease in earned depletion benefits which are treated as a tax rate reduction in the year claimed. The absence of *extraordinary income* in 1976 reflects the exhaustion of accumulated loss carry-forwards in the preceding year.

The increase in *net earnings* for 1975 over the preceding year was due principally to a significant increase in the price of metallurgical coal. The price of coal exported to Japan during the year increased by $22.16 per ton to $52.40 at December 31, 1975.

The increase in *net earnings* for 1974 was primarily related to improving prices for metallurgical coal and extraordinary income which resulted from the application of prior years loss carry-forwards to reduce income taxes otherwise payable. The price of metallurgical coal shipped to Japan increased by $9.99 per ton in the year.

Corporate Directory

Directors

Edgar F. Kaiser, Jr.*
Chairman of the Board
Chairman of the Executive Committee
and Chief Executive Officer
Kaiser Resources Ltd., Vancouver

Graham R. Dawson*
Vice-Chairman, Kaiser Resources Ltd.
President, Dawson Construction Limited,
Vancouver
(heavy construction contractors)

Howard E. Cadinha
Executive Vice-President,
Finance and Administration
Kaiser Resources Ltd., Vancouver

Roger T. Hager*†
Retired Chairman
The Canadian Fishing Company Limited,
Vancouver (fish processing)

Enji Haseo
Managing Director, Ferrous Metals
Mitsubishi Corporation,
Tokyo (trading company)

Robert W. MacPhail
Senior Vice-President
Kaiser Resources Ltd., Vancouver

John W. Poole*
President and Chief Executive Officer
Daon Development Corporation,
Vancouver (real estate development)

Walter J. Riva
President, Coal Division
Kaiser Resources Ltd., Vancouver

Edward A. Tory†
Partner, Campbell, Godfrey & Lewtas
Toronto (barristers and solicitors)

William J. Whelan
President, Oil and Gas Division
Kaiser Oil Ltd., Calgary

George L. Wilcox
Director-Officer
Westinghouse Electric Corporation
Pittsburgh, Pennsylvania
(electrical equipment manufacturing)

E.D.H. Wilkinson, Q.C.†
Partner, Russell & DuMoulin
Vancouver (barristers and solicitors)

Officers

Edgar F. Kaiser, Jr.
Chairman of the Board
Chairman of the Executive Committee
Chief Executive Officer

Walter J. Riva
President
Coal Division

William J. Whelan
President
Oil and Gas Division

Howard E. Cadinha
Executive Vice-President
Finance and Administration

George L. Farinsky
Senior Vice-President
Corporate Development

Robert W. MacPhail
Senior Vice-President

Christopher H. Hebb
Vice-President
General Counsel and Secretary

Hans J. Krutzen
Vice-President
Executive Division

Ward P. Popenoe
Vice-President
Administration

Michael R. Whitman
Vice-President

Bent H. Larsen
Controller

Thomas A. Beckett
Assistant Secretary
Chief Counsel, Coal Division

Peter J. Surrao
Assistant Secretary

Kaiser Resources Ltd.

Executive Offices
1500 West Georgia Street
Vancouver, B.C. V7G 2Z8
Telephone (604) 681-9211

Coal Division
Box 2000
Sparwood, B.C. V0B 2G0
Telephone (604) 425-8221

Oil and Gas Division
639 - Fifth Avenue S.W.
P.O. Box 6800, Stn. D
Calgary, Alta. T2P 0N1
Telephone (403) 266-7611

Westshore Terminals Ltd.
Roberts Bank
Delta, B.C. V4K 3N2
(604) 946-4491

Kaiser Resources (U.S.) Ltd.
800 - 3rd Avenue
New York, N.Y. 10022
(212) 832-0850

300 Lakeside Drive
Oakland, Ca. 94604
(415) 271-5088

1340 Beneficial Life Tower
36 South State Street
Salt Lake City, Utah 84111
(801) 532-3535

Auditors
Touche Ross & Co.

Transfer Agent
Canada Permanent Trust Company
Vancouver, Calgary, Regina,
Winnipeg, Toronto, Montreal

Registrar
National Trust Company Limited
Vancouver, Calgary, Regina,
Winnipeg, Toronto, Montreal

Shares Listed
Vancouver, Toronto and
Montreal Stock Exchanges

Annual Meeting
The annual meeting of shareholders will be held on May 15, 1979 at the Bayshore Inn, 1601 West Georgia Street, Vancouver, B.C. at 11:00 a.m. local time.

Form 10-K
A copy of the Annual Report on Form 10-K, filed with the United States Securities and Exchange Commission, is available without charge upon request to the Public Affairs Department at the company's executive offices in Vancouver, British Columbia.

*Member of Executive Committee
†Member of Audit Committee

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NCY PRESS LIMITED
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KAISER
RESOURCES

KAISER RESOURCES LTD.
CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

(Thousands)

	Three Months Ended June 30		Six Months Ended June 30	
	1978	**1977(A)**	**1978**	**1977(A)**
Sales	$72,041	$81,799	$149,452	$154,905
Interest and other income, net	2,182	2,449	4,467	5,051
	74,223	84,248	153,919	159,956
Costs and expenses:				
Cost of products sold	36,180	38,110	75,571	71,530
General and administrative	4,891	4,551	9,445	8,488
Mineral land and property taxes	2,445	2,369	4,891	4,741
Interest on long-term debt	—	215	—	457
Depreciation and depletion	2,831	2,792	5,624	5,466
Amortization of preproduction and development costs	400	400	800	800
	46,747	48,437	96,331	91,482
Earnings before provision for income taxes	27,476	35,811	57,588	68,474
Provision for income taxes:				
Current	10,135	16,604	24,473	31,963
Deferred	5,104	3,035	7,498	5,826
	15,239	19,639	31,971	37,789
Net earnings	$12,237	$16,172	$ 25,617	$ 30,685
Weighted average number of shares outstanding	26,818	26,789	26,815	26,782
Net earnings per share	$ .46	$ .60	$ .96	$ 1.15

Note: (A) Restated to reflect the extension in 1977 of the estimated useful lives of certain assets.

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KAISER RESOURCES LTD.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Unaudited)

(Thousands)

	Six Months Ended June 30	
	1978	**1977**
Source of Funds:		
Net earnings	$ 25,617	$ 30,685
Depreciation, depletion and amortization	6,424	6,266
Provision for income taxes	7,498	5,826
Loss (gain) on sale of assets	(152)	231
Total funds provided by operations	39,387	43,008
Capital stock issued	109	430
Proceeds from sale of assets	439	205
	39,935	43,643
Application of Funds:		
Property, plant and equipment purchases	14,010	14,868
Other assets acquired	6,735	618
Reduction of long-term debt	—	3,497
Dividends paid	12,067	11,521
	32,812	30,504
Increase in working capital	7,123	13,139
Working capital at beginning of period	125,817	102,380
Working capital at end of period	$132,940	$115,519

Approved by the Directors:
Edgar F. Kaiser, Jr., Director
E. D. H. Wilkinson, Q.C., Director

WESTERN MINER PRESS LTD.

KAISER RESOURCES

Report to Shareholders First Half of 1978

TO OUR SHAREHOLDERS:

Kaiser Resources had consolidated net earnings of $12,237,000 or 46 cents per share in the second quarter of 1978, compared with restated 1977 second quarter earnings of $16,172,000 or 60 cents per share. Sales for the quarter amounted to $72,041,000, compared with $81,799,000 in the 1977 second quarter.

For the first six months of 1978, the company had consolidated net earnings of $25,617,000 or 96 cents per share, compared with restated earnings of $30,685,000 or $1.15 per share in the first half of 1977. Sales for the first six months of this year totalled $149,452,000, compared with $154,905,000 in the same period of 1977.

Earnings in the second quarter of 1978 were lower than earnings in the comparable 1977 quarter primarily as a result of a lower level of metallurgical coal shipments and the inability of the company, under the interim billing procedure, to recover certain increased costs through escalation provisions of our Japanese sales contract. We are continuing negotiations with our Japanese customers and partners on the price and escalation provisions for metallurgical coal to be effective April 1, 1978. Until agreement is reached, we will continue to bill our customers for coal delivered at $57.23 per long ton, the price in effect on March 31.

Metallurgical coal shipments during the second quarter of 1978 totalled 1,152,000 long tons, compared with 1,353,000 long tons in the second quarter of 1977.

Consistent with our efforts to broaden our earnings base in the energy field, our board of directors and the board of Ashland Oil, Inc. of Kentucky have approved a definitive agreement for the sale of Ashland's 83 percent interest in Ashland Oil Canada Limited of Calgary to Kaiser Resources at a price of $33.50 per share. The transaction is subject to approval under the Foreign Investment Review Act.

Subject to the acquisition of the Ashland Oil's 83 percent interest, Kaiser Resources has agreed to make an offer to acquire the remaining common shares of Ashland Canada at an equivalent price. The total purchase price of all of the shares of Ashland Canada, outstanding and issuable on the conversion of debentures, is approximately $485 million. Arrangements for long-term financing of the transaction have been concluded with our Canadian bankers.

We believe that the acquisition of Ashland Canada is an excellent opportunity for our shareholders to participate to a greater extent in the development of Canada's energy resources.

This acquisition is being made at a time in which the company's coal business is experiencing soft market conditions. The purchase of Ashland Canada is the first major diversification for the company and is consistent with the previous investments that we have made in the oil and gas industry, both in the Sable Island area with Petro-Canada and in the Beaufort Sea with Dome Petroleum. One of the key ingredients in this acquisition was our confidence in and respect for the management of Ashland Canada. They are a welcome and strong addition to our existing management team.

Ashland Canada is primarily engaged in exploration for and production of oil and natural gas in Canada. The company has proven reserves of 97 million barrels of oil and 495 billion cubic feet of gas as well as extensive land holdings in British Columbia, Alberta and Saskatchewan.

In other corporate developments during the second quarter, a new three-year collective agreement was signed with Local 7292 of the United Mine Workers of America at Sparwood, B.C. The agreement is retroactive to January 1, 1977 and has been submitted to the Anti-Inflation Board for approval.

Westshore Terminals Ltd., the company's wholly-owned subsidiary which operates the Roberts Bank port south of Vancouver, signed a contract with Luscar Ltd. of Edmonton to ship approximately 10 million long tons of thermal coal over a 15-year period through Westshore's bulk-handling facilities. The contract calls for the shipment of 650,000 long tons of thermal coal per year from June 1, 1978 through May 31, 1993.

The regular quarterly dividend of 22½ cents per share was paid on June 29 to shareholders of record at the close of business on June 15.

July 19, 1978

Edgar F. Kaiser Chairman	Edgar F. Kaiser, Jr. President and Chief Executive Officer

KAISER RESOURCES

Executive Offices:
2600 Board of Trade Tower
1177 West Hastings Street
Vancouver, B.C. V6E 2L1